

Office of Chief Counsel  
Internal Revenue Service  
**memorandum**

CC:NER:MAN:TL-N-1256-97  
EPFlores

date:

to: Chief, Examination Division, Manhattan District  
Attention: Harold Neutuch

from: District Counsel, Manhattan

subject:

████████████████████  
Taxable Years Ending December 31, ██████ and December 31, ██████  
Statute of Limitations Expires on ████████████████████

UIL No. 162.05-03

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This memorandum is our response to your request for advice as to whether ████████████████████ can deduct under I.R.C. § 162<sup>1</sup> payments made pursuant to the settlement of various antitrust lawsuits. Our advice is based on the facts provided by you and that are set forth in this memorandum.

**ISSUE:**

Whether ██████████ can deduct under section 162 payments made pursuant to the settlement of various antitrust lawsuits.

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<sup>1</sup> All further references to "section" or "§" will be to the Internal Revenue Code in effect during the years in issue.

**FACTS:**

██████ was named as a co-defendant in various antitrust lawsuits and investigations relating to its marketing and sale of ██████. The plaintiffs in these lawsuits alleged that ██████ conspired with one or more of its competitors to fix prices of ██████ and monopolized the market for ██████ products. ██████ and the plaintiffs agreed to resolve these lawsuits as shown below:

1. State of ██████ (on its own behalf (including its departments) and as assignee of the ██████ claims of ██████, ██████ and ██████) v. ██████, ██████

Settlement amount: \$ ██████, paid in ██████. Both parties also agreed that the entire \$ ██████ was not, and could not be characterized as, a civil penalty or payment in respect of claims asserted by the State of ██████ in its own right.

2. ██████, ██████

Settlement Amount: \$ ██████, paid in ██████.

3. In Re ██████  
Antitrust Litigation, Judicial Council Coordination  
Proceeding No. ██████, ██████

Settlement Amount: \$ ██████, paid in ██████. ██████ also agreed to deliver, free of charge, to ██████ in ██████ having a total value of \$ ██████. ██████ deducted in ██████ the amount of \$ ██████ representing the total cost of the ██████.

4. ██████ (on its own behalf and as assignee of ██████), ██████, Case No. ██████

Settlement Amount: \$ ██████, paid in ██████.

5. [REDACTED], class action  
portion of [REDACTED]  
[REDACTED]

Settlement Amount: \$ [REDACTED], paid in [REDACTED].

6. [REDACTED], Civil Action No. [REDACTED]  
[REDACTED]

[REDACTED]. In this action, the Federal Trade Commission ("FTC") sought permanent injunctive and other equitable relief for alleged unfair methods of competition by [REDACTED] in connection with the sale and marketing of [REDACTED].

Settlement: [REDACTED] agreed to resolve this case without admitting any of the FTC's allegations in the complaint and without admitting that it violated Section 5 of the FTC Act, 15 U.S.C. § 45. [REDACTED] entered into a stipulation with the FTC to settle charges involving unilateral activity by [REDACTED] relating to [REDACTED] bid in connection with the [REDACTED].

[REDACTED] This stipulation resulted in a consent decree prohibiting [REDACTED] from engaging in certain conduct relating to [REDACTED] bids and requiring [REDACTED] to provide certain quantities of [REDACTED] to the [REDACTED]. [REDACTED] also agreed to deliver to the [REDACTED] pounds<sup>2</sup> of [REDACTED]. Under the agreement, no portion of the goods or services provided under the agreement would be deemed a payment of any fine, penalty, or punitive assessment.

[REDACTED] settled the above lawsuits without admitting any allegations of the complaints and without admitting that it was liable for any of the violations cited in the complaints. [REDACTED] settled these lawsuits in order to reduce the expense, inconvenience and the distraction of burdensome and protracted litigation.

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<sup>2</sup> It is our understanding that [REDACTED] delivered this [REDACTED] in [REDACTED]. However, we do not have any information showing the amount [REDACTED] deducted on its return and whether the amount deducted represents the [REDACTED]'s cost or value.

**DISCUSSION:**

██████ has substantiated these payments so that the only remaining issue is whether ██████ properly deducted such payments under section 162. Under section 162(a), a taxpayer is entitled to a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

The origin and character of a claim with respect to which a settlement is made, rather than its potential consequences on the business operations of a taxpayer, is the controlling test of whether a settlement payment constitutes a deductible expense or a nondeductible capital outlay. Anchor Coupling Company, Inc. v. United States, 427 F.2d 429 (7th Cir. 1970), cert. denied, 401 U.S. 908 (1971). Also, in H.M. Howard v. Commissioner, 22 B.T.A. 375 (1931), the Tax Court held that the taxpayer therein was entitled to a business expense deduction for payments it made in lieu of litigation. In so holding, the Court noted that the settlement payment expense was attributable to, and proximately resulted from, the business dealings between the taxpayer therein and the plaintiff in the lawsuit and that such expense did not result in the acquisition of any capital assets.

The plaintiffs in the subject lawsuits alleged that ██████ conspired with one or more of its competitors to fix prices of ████████████████████ and monopolized the market for ████████████████████ products. The activities forming the basis for the litigation were performed in the ordinary conduct of ██████'s trade or business. The lawsuits herein do not concern the protection of ██████'s capital assets. Therefore, the amounts paid by ██████ under the settlement agreements are ordinary and necessary expenses of carrying on ██████'s trade or business within the meaning of section 162(a).

We also considered whether the settlement payments to the State of [REDACTED] and the FTC fall within the exceptions to the deductibility of expenses under section 162. Under section 162(f), a taxpayer is not entitled to a deduction for any fine or similar penalty paid to a government for the violation of any law. Treas. Reg. § 1.162-21(b)(1) states that a fine or similar penalty includes an amount "(ii) paid as a civil penalty imposed by Federal, State or local law" or "(iii) paid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal)". Compensatory damages (including damages under section 4A of the Clayton Act (15 U.S.C. § 15a, as amended)) paid to a government are excluded from the definition of fine or penalty and are deductible. Treas. Reg. § 1.162-21(b)(2).

[REDACTED]'s payments to the FTC (in the form of [REDACTED]) and the State of [REDACTED] were not "fines" or "penalties" under section 162(f). In both cases, the parties agreed that the settlement payments were not payments of fines, penalties or punitive assessments. Furthermore, [REDACTED]'s agreement to deliver [REDACTED] pounds of [REDACTED] to the [REDACTED] was clearly compensatory in nature. [REDACTED] settled these lawsuits without admitting any wrongdoing and did so in order to avoid litigation.

Finally, section 162(g) precludes the deductibility of an otherwise deductible section 162 expense in the case of a criminal conviction of an antitrust violation or in a case where a taxpayer pleads guilty or nolo contendere to an indictment or information charging such violation. Section 162(g) does not apply here because [REDACTED] was not criminally convicted of an antitrust violation and nor did it plead guilty or nolo contendere to an indictment or information charging an antitrust violation.

**CONCLUSION:**

Under section 162, [REDACTED] is entitled to deduct the payments made pursuant to its settlement of the lawsuits described above and the the limitations on deductibility under sections 162(f) and 162(g) do not apply. If you have any questions, please contact Lisa Flores at 212-264-5473 extension 232.

FRANCES F. REGAN  
Acting District Counsel

By: \_\_\_\_\_  
ROBERT B. MARINO  
Assistant District Counsel

Noted:

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